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No. 417

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1954

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LEWYT CORPORATION (now known as LEWYT MANUFACTURING CORPORATION), *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE.

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**On Writ of Certiorari to the United States Court of Appeals For the Second Circuit**

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## BRIEF FOR PETITIONER

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## BRIEF FOR PETITIONER

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### OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 23) is reported in 18 T. C. 1245. The opinion of the Court of Appeals for the Second Circuit (R. 57) is reported in 215 F. (2d) 518.

### JURISDICTION

The judgment of the Court of Appeals was entered July 14, 1954. (R. 74.) A timely petition for rehearing, filed on July 28, 1954, was denied on August 24, 1954. (R. 75.) The petition for a writ of certiorari was filed on October 20, 1954 and was granted on December 6, 1954. (R. 75.) The jurisdiction of this Court rests on 28 U. S. C. Section 1254 (1).

## QUESTIONS PRESENTED

1. Whether excess-profits taxes paid within a taxable year with respect to a taxpayer's excess-profits tax liability for taxes accrued in the preceding year constitute excess-profits taxes "paid or accrued within the taxable year" under Section 122 (d)(6) of the Internal Revenue Code so as to enable a taxpayer on the accrual basis to add the amount of such taxes to its net operating loss for the taxable year in which they were paid.

2. Whether under Section 122 (d)(6) and Section 122 (b)(1) of the Internal Revenue Code the "tax imposed by Subchapter E of Chapter 2 [Excess-Profits Tax] * * * accrued within the taxable year" is the excess-profits tax computed on the basis of the facts existing at the end of such taxable year (as shown on the taxpayer's return for such year) or whether it is the excess-profits tax ultimately determined to be due after application of a carry-back and other circumstances arising in a later year.

## STATUTE INVOLVED

The directly pertinent statutory provisions (Sections 21 (a), 23 (s), 41, 43, 48(c) and 122 of the Internal Revenue Code of 1939),[1] together with certain other provisions of the Code and of revenue acts also involved, are set forth in Appendix A, pp. 53-65.

## STATEMENT

The material facts, which are not in dispute, are as follows:

This case involves deficiencies determined by the Commissioner of Internal Revenue of income tax for the taxable year ended September 30, 1944, and of excess-profits tax for the taxable year ended September 30, 1945.[2] (R. 2.)

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[1] All references to the "Internal Revenue Code" or to the "Code" are to the "Internal Revenue Code of 1939."

[2] Each fiscal year is hereafter designated simply by the calendar year in which it ended.

The dispute to which this Court has confined its review (R. 75) relates to whether the Commissioner of Internal Revenue was correct (Question 1) in limiting the taxpayer's net operating loss deduction for 1944 (based upon a net operating loss in 1946) to $164,326.38, and (Question 2) in not allowing any net operating loss deduction for 1945 based upon petitioner's 1946 net operating loss, whatever it may be.

*Question 1. Amount of 1946 Net Operating Loss.* Section 23 (s) of the Code provides that in computing net income there shall be allowed "the net operating loss deduction computed under section 122." (Appendix A, p. 54.) The net operating loss *deduction* for any year is based upon *"net operating losses"* incurred in other years and the net operating loss deduction for 1944 in this case depends upon the amount of taxpayer's net operating loss in 1946.

Section 122 (a) of the Code defines the term "net operating loss" to mean "the excess of the deductions allowed by this chapter [Chapter 1—Income Tax] over the gross income, with the exceptions, additions, and limitations provided in subsection (d)." (Appendix A, p. 57.) The parties are agreed that for 1946 the net operating loss is $164,326.38 without taking into account the adjustment under subsection (d)(6) of Section 122. (R. 24, 38.) The dispute under Question 1 is confined to whether the taxpayer is entitled to make a "(d)(6)" adjustment in 1946.

Section 122 (d)(6) provides that "There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 [Excess-Profits Tax] *paid or accrued* within the taxable year * * *." (Appendix A, p. 59.) The taxpayer files its income and excess-profits tax returns on the accrual basis. (R. 24, 38.) Since, as indicated above, the taxpayer incurred a loss in 1946, no excess-profits tax liability arose (accrued) in that year. However, in 1946 the taxpayer paid the amount of the excess-profits tax

liability ($861,118.04) accrued and shown on its return for 1945.[3] (R. 25, 38.)

The Commissioner determined that this payment did not constitute excess-profits taxes "paid or accrued within the taxable year" 1946 under Section 122 (d)(6) and hence could not be added to the taxpayer's admitted net operating loss of $164,326.38 for 1946. (R. 2-3.) The Tax Court (R. 23) and the Court of Appeals (R. 57) affirmed, ruling that under Section 122 (d)(6) an accrual basis taxpayer could not add to its net operating loss for a taxable year the amount of excess-profits taxes *paid* within such taxable year on account of its liability for taxes accrued in the previous year. Taxpayer contends that such tax payment should be included in its 1946 net operating loss and that its total 1946 net operating loss should therefore be $1,025,444.42 instead of $164,326.38 as contended by the Government.

*Question 2. 1946 Net Operating Loss Carry-Back to 1945.* Question 2 relates to how much, if any, of the 1946 net operating loss (determined under Question 1) may be carried back to 1945 and taken as a net operating loss deduction in that year. Section 122 (b)(1) (Appendix A, p. 57), as applied to this case, provides that the amount of the 1946 net operating loss which may be carried back to 1945 is "the excess, if any, of the amount of such net operating loss over the net income for" 1944 "computed (A) with the" adjustment "provided in subsection (d) * * * (6) [of Section 122], and (B) by determining the net operating loss deduction for" 1944 "without regard to such net operating loss." The computation of 1944 net income required under clauses (A) and (B) is as follows:

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[3] After taking into account, among other things, a net operating loss deduction arising out of a net operating loss carry-back from 1947 (R. 11, 13), the Commissioner subsequently determined that taxpayer's excess-profits tax liability for 1945 was a smaller amount. (R. 2.)

(1) Compute 1944 net income by determining the 1944 net operating loss deduction without regard to the 1946 net operating loss (Clause (B) of Section 122 (b)(1)).

(2) Reduce the amount of the 1944 net income as computed in (1) above by the Section 122 (d)(6) adjustment for the "tax imposed by Subchapter E of Chapter 2 [Excess-Profits Tax] paid or accrued within the taxable year" 1944 (Clause (A) of Section 122 (b)(1)).

Under Section 122 (b)(1) the excess of the 1946 net operating loss over 1944 net income, computed as set forth in (1) and (2) above, may be carried back to 1945. Unless the 1946 net operating loss exceeds the 1944 net income (so computed), there will not, of course, be any carry-back to 1945.

There is no dispute that the taxpayer's 1944 net income computed without regard to the 1946 net operating loss (Clause (B); (1) above) was $584,866.81.[4] (R. 70.) The issue under Question 2 therefore is the amount by which such net income should be reduced (Clause (A); (2) above) under Section 122 (d)(6) by reason of "the amount of tax imposed by Subchapter E of Chapter 2 [Excess-Profits Tax] paid or accrued within the taxable year" 1944.

If taxpayer should prevail under Question 1, it contends that the amount of the 122 (d)(6) adjustment to 1944 net income is $759,916.50, the amount of the 1943 excess-profits taxes admittedly *paid* in 1944 (R. 24, 38), rather than, as the Government contends, $140,147.87,[5] the excess-profits tax liability ultimately determined for 1943.

If the Government should prevail under Question 1, then the question will arise, as it did below (R. 71), as to the amount of excess-profits tax *accrued* in 1944. The excess-

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[4] Taxpayer's 1944 net income was determined to be $420,540.43 (R. 4, 9) after allowance of a net operating loss carry-back from 1946 of $164,326.38. (R. 4, 6.) The amount of $584,866.81 set forth in the text is the sum of these amounts.

[5] This figure is set forth at p. 134 of the Original Transcript of Record filed in this Court.

profits tax due as shown on the taxpayer's excess-profits return for 1944 was $625,561.59. (R. 40A, Item 20.) Upon the filing of such return, an assessment of tax was actually made against the taxpayer in such amount.[6] (R. 9.) After taking into account, among other things, a net operating loss carry-back of $164,326.38 subsequently arising in 1946 (R. 4, 6), the Commissioner ultimately determined taxpayer's excess-profits tax liability for 1944 to be $280,540.33.[7] (R. 2, 9.) The Court of Appeals[8] ruled that the "excess profits taxes which accrued for 1944" (R. 72) were this amount,[9] rather than, as taxpayer contends, $625,561.59, the amount of excess-profits taxes shown on the taxpayer's return upon the basis of the facts existing at the end of 1944.

As earlier noted, the 1944 net income adjusted under Section 122 (b)(1)(*B*) was $584,866.81. Having found the excess-profits tax "accrued" in 1944 (the adjustment under Section 122 (b)(1)(*A*)) to be $280,540.33, the Court determined the net income computed as required by Section 122 (b)(1) to be $304,326.48, that is $584,866.81 minus $280,540.33. Since the 1946 net operating loss of $164,326.38 did not, of course, exceed $304,326.48, under the Court's decision none of such loss could be carried back to 1945. (R. 72.)

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[6] Taxpayer filed an amended return (R. 50A) for 1944 prior to the due date of the last installment of tax and hence the total payments ($510,939.23) made for 1944 (R. 39) were smaller than the amount assessed on the basis of its original return.

[7] The amount set forth is that stated in the Opinion below. (R. 71.) This is done for purposes of clarity only since the figure represents the tax *after* debt retirement credit (R. 9) rather than the tax *before* debt retirement credit. A *before* debt retirement figure was used by the Court below (R. 71) in connection with the tax ($625,561.59) shown on the 1944 return. (R. 40A, Item 20.)

[8] The Tax Court did not discuss Question 2, being under the mistaken impression that its decision on Question 1 would dispose of Question 2. (R. 36.) The Commissioner's statutory notice (R. 1) also did not refer to Question 2.

[9] The Court also stated that this was the amount of tax "imposed" for 1944. (R. 71.)

## SUMMARY OF ARGUMENT

### I

A. Section 122 (a) of the Code provides that "net operating loss" means the excess of deductions over gross income with the addition to such loss (under Section 122 (d)(6)) of excess-profits taxes "*paid or accrued* within the taxable year." The holding of the Court below that an *accrual* basis taxpayer may not take into account under Section 122 (d)(6) taxes *paid* within the taxable year would largely read this provision out of the Code so far as accrual basis taxpayers are concerned and limit its benefits to cash basis taxpayers. This is so because taxes based on income —such as excess-profits taxes—do not, of course, ordinarily arise (*accrue*) in a loss year. On the other hand, excess-profits taxes are *payable* in the year subsequent to the year in which the liability arises. Hence, when a loss year follows a profit year, taxpayers will *pay* the excess-profits taxes for the profit year in the loss year. Thus, under the decision of the Court below, accrual basis taxpayers ordinarily cannot obtain relief under Section 122 (d)(6) whereas cash basis taxpayers ordinarily can.

It is no answer to suggest—as does the Government (Brief in *United States* v. *Olympic Radio and Television, Inc.*, No. 10, p. 18)—that discrimination does not exist because an accrual basis taxpayer may on occasion obtain some benefit under the construction of Section 122 (d)(6) adopted by the Court below if he should settle (and hence "accrue") a contested tax liability of an earlier year in a loss year. Surely, it was not the purpose of the Congress in enacting Section 122 (d) (6) to limit its benefits to the relatively few taxpayers who contest tax liability and thus to make equality the exception and discrimination the rule.

While the Court below candidly recognized "the force" of these equities, it stated it could not take them into account without "ignoring the plain mandate of the statute."

(R. 69.) The Court found this mandate in Section 48 (c) of the Code. That section provides that "When used in this chapter" (Chapter 1, entitled "Income Tax") "the terms * * * 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part." Where applicable (as in the case of Section 23 (c) of the Code), this definition, of course, limits accrual basis taxpayers to deductions for taxes or other amounts accrued within the taxable year. But this definition does not apply to Section 122 (d)(6).

The established rule (*Commissioner* v. *Clarion Oil Co.*, 148 F. (2d) 671 (App. D. C. 1945), *cert. den.*, 325 U. S. 881 (1945), and similar cases, involving virtually identical adjustments to net income for taxes "paid or accrued") is that the term "paid or accrued" may have different meanings in the Internal Revenue Code, and that, where appropriate to carry out the statutory purpose, the ordinary meaning of *either* "paid or accrued" will be applied rather than the statutory definition in Section 48 (c). And this Court has ruled (*Helvering* v. *Morgan's Inc.*, 293 U. S. 121, 128 (1934)), with respect to forerunners of the definition and substantive sections of law here involved, that "The same meaning need not always be attributed to a phrase which, by hypothesis, has more than one meaning for purposes of statutory construction." In that case, the Court adopted the construction which would in its judgment best fulfill the statutory purposes. In this case, where by hypothesis the phrase in issue likewise has more than one meaning, adoption of the meaning of *either* "paid or accrued" is necessary in order to carry out with respect to *all* taxpayers the Congressional purpose of according a deduction for excess-profits taxes so as to provide a loss carry-back for the actual economic loss suffered.

While accepting the *Clarion Oil* rule, the Court below held that line of cases, which arose under Chapter 2 of the Code, not applicable, stating that (R. 68):

> "* * * Chapter 2 contains no provisions comparable to § 48 (c) and § 43 of Chapter 1 defining the phrase 'paid or accrued.'"

In this the Court below was plainly in error, the Court having overlooked Section 507 (a) of Chapter 2 of the Code which states that

> "The terms used in this subchapter [subchapter A of Chapter 2, the statute involved in *Clarion Oil*] shall have the same meaning as when used in chapter 1."

Not being under this misapprehension, the Court of Claims in the *Olympic Radio* case (No. 10) stated it would apply to Section 122 (d) (6) the rule of *Clarion Oil* that Section 48 (c) "should not be applied in all circumstances and regardless of consequences." (108 F. Supp. at 111.) In ascertaining the Congressional purpose in enacting Section 122 (d)(6), the Court of Claims appropriately took into account the discrimination against accrual taxpayers which would result from applying Section 48 (c) just as the Court in *Clarion Oil* (148 F. (2d) at 676) in holding Section 48 (c) inapplicable reasoned that Congress did not intend to discriminate between cash and accrual basis taxpayers.

B. The legislative background of Section 122 (d)(6) evidences a clear Congressional purpose to afford real and not illusory relief to taxpayers under Section 122 (d) (6). Section 105 of the Revenue Act of 1942 changed the base for the corporate income tax by eliminating the *deduction* for excess-profits taxes (theretofore provided in Section 23 (c)(2) of the Code) and substituting (in Section 26 (c) of the Code) a *credit* against *net income* equal to the amount of income subject to excess-profits taxes. "Technical amendments" were therefore necessary where it was desired to extend the benefits of the Section 26 (c) credit, or benefits in lieu thereof, to other sections of the Code in which the terms "net income" or "deductions" were used.

In subsection (c)(2) of Section 105 of the 1942 Act,

the credit in Section 26 (e) of the Code was made applicable to the computation of "section 102 net income." But in the immediately succeeding subsection, subsection (e)(3), which enacted Section 122 (d)(6), of the Code, the draftsmen did *not* make the Section 26 (e) credit applicable to the computation of "net operating loss." The reason is evident. Such credit would have been useless in computing a net operating loss since there would be no income subject to excess-profits tax in a loss year. Congress nevertheless determined that an amendment to Section 122 of the Code was advisable and subsection (e)(3) of Section 105 added the Section 122 (d)(6) adjustment for "taxes paid or accrued within the taxable year" to the Code. This adjustment could only have been designed to permit taxpayers to take into account taxes of other years. Otherwise, it would have been as futile as the Section 26 (e) credit since no taxes can arise in a loss year.

There is another clear indication of a conscious Congressional intent to provide meaningful and not theoretical relief in Section 122 (d)(6). The language of Section 122 (d)(6) was taken virtually verbatim from Section 23 (e)(2) of the Code (as in effect prior to its repeal by the 1942 Act) except that one of four rules set forth therein (Rule A) was omitted. That rule provided:

> "The deduction shall be limited to the tax imposed for the taxable year, but any portion of such tax paid after the taxable year shall be considered as having been paid within the taxable year."

Had this rule been retained, Section 122 (d)(6) would have been futile since there can be no tax imposed in a loss year.

The Government's analysis of the legislative history (*Olympic Radio* Brief, pp. 22-34) is manifestly unsound, it being directed toward proof of the proposition that Congress did not intend to permit a corporation to take "a novel and far-reaching deduction" for taxes "*both* paid

and accrued." (*Olympic Radio* Brief, p. 33.) The contention here and in *Olympic Radio* is that a taxpayer under Section 122 (d)(6) may make an adjustment for taxes *either* paid or accrued. Indeed, the Government does not consider at all subsection (c)(2) of Section 105 of the 1942 Act and attempts to explain the omission from Section 122 (d)(6) of Rule A of Section 23 (c)(2) as an effort by Congress to benefit cash but not accrual basis taxpayers. (*Olympic Radio* Brief, p. 26.) The Government gives no reason why the Congress should have taken such pains to benefit only the comparatively few cash basis corporate taxpayers. And it is hardly credible that, in enacting a "technical amendment" designed "to make it all come out straight," Congress intended *sub silentio* to reverse the policy of according the same treatment to cash and accrual basis taxpayers announced in the preceding year by the Congressional committees when they enacted the predecessor provision of Section 122 (d)(6).

More fundamentally, the Government's analysis of the legislative history (*Olympic Radio* Brief, p. 26 *et seq.*) proceeds in substance on the premise that the Congress made a mistake in policy in enacting Section 122 (d)(6). Thus the Government argues that "the allowance of the tax itself as a deduction" grants a "double benefit," which Congress could not have intended. (*Olympic Radio* Brief, p. 27.) But if it be assumed, *arguendo*, that such is the effect of the allowance of the tax as a deduction, the effect would be identical in the case of cash basis taxpayers. Yet cash basis taxpayers are admittedly entitled to deductions under Section 122 (d)(6). In contrast to the doctrinaire exception taken by the Government to the Congressional policy of permitting a deduction for excess-profits taxes under Section 122 (d)(6), the taxpayer, in its analysis of the legislative history, accepts Section 122 (d)(6) as an expression of the Congressional policy to

permit taxpayers to take into account excess-profits taxes in determining their "net operating" or economic loss.

## II

Section 122(b)(1), as applied to this case, permits the 1946 net operating loss to be carried back to 1945 to the extent such net operating loss exceeds the 1944 net income computed by determining the net operating loss deduction for 1944 without regard to the 1946 net operating loss and by reducing such net income by the "(d)(6)" adjustment. Under the decision of the Court below on Question 1, the latter adjustment is for the "tax imposed by Subchapter E of Chapter 2 * * * *accrued* within the taxable year" 1944. The Court below held the tax "accrued" within 1944 was not the tax computed on the basis of the facts existing at the end of such year and shown on the taxpayer's return but was the tax after carry-back from 1946.

But under long-established principles recognized in a specific ruling of the Commissioner, the tax accrued in a taxable year is the tax before carry-back from a later year The Government did not dispute this principle below and, indeed, the opinion of the Court below (R. 71) does not appear to question it. Instead, the Court below fixed the amount which it thought appropriate to carry out the purpose of Section 122 (b)(1) as the Court conceived it and held such amount to be the tax "accrued." Specifically, the Court thought the statutory design required that the tax "accrued" for 1944 must "match" (that is, must be the tax computed upon the basis of) the "income" figure for that year from which it was to be subtracted under subsection (b)(1). Paradoxically, the figure held to be the tax accrued did not in fact "match" the income figure from which it was subtracted by the Court since such tax accrued figure—which was the tax computed on the basis of the income *after* carry-back—was subtracted by the Court from the income *before* carry-back.

More fundamentally, the admitted application of Section 122 (b)(1) to other situations plainly shows that the

statute does not contemplate "matching." For example, the (d)(6) adjustment for a cash basis taxpayer in the year 1944 would be the excess-profits tax paid in that year on *1943 income*. Under Section 122 (b)(1) this figure would be applied to reduce the *1944 income*, which it cannot conceivably "match." Even if it be assumed that the Court below would have been justified in disregarding the "plain mandate" of Section 122 (b)(1) to carry out an overriding Congressional purpose, the purpose attributed by the Court to Congress is therefore specifically negatived by the conceded meaning of Section 122 (b)(1) in other situations.

As already noted, Section 122 (d)(6) permits a deduction for the "tax *imposed* by Subchapter E of Chapter 2 [Excess-Profits Tax] paid or accrued within the taxable year." The Government argued below and intends to argue in this Court (*Olympic Radio* Brief, pp. 21-22) that the amount of the (d)(6) adjustment is the tax "imposed" for the year and that the amount of tax "imposed" is the tax finally determined for the year after application of carrybacks. But the word "imposed" is used in Section 122 (d)(6), as in many other places in the Code where a tax cannot be suitably identified by use of a generic name, merely by way of identification of the particular tax referred to. It is not used in Section 122 (d)(6) in a quantitative sense to define an *amount* of tax, that function being performed by the words "paid or accrued."

This is clearly demonstrated by the language of the Congressional committee reports describing Section 122 (d)(6). The context being such as to make it apparent which excess-profits tax was referred to, the reports stated that Section 122 (d)(6) of the Code allowed "the excess-profits tax *paid or accrued* within taxable years" as a deduction. The word "imposed" does not appear. That the word "imposed" is used in Section 122 (d)(6) by way of reference only is also evident on the face of Section 23 of the Code, which allows a deduction in computing net income for taxes "paid or accrued." There, the word

"imposed" is employed where necessary for identification of a particular tax but not used when generic terms are appropriate. Indeed, as Section 23 (from which Section 122 (d)(6) was derived) has changed its form from time to time a deduction has sometimes been allowed for particular taxes "paid or accrued" without use of the word "imposed," and at other times when required by way of identification the word "imposed" has been employed by way of reference to the *same* taxes. The test for deductibility of such taxes is of course no different when the word "imposed" happens to be used.

Even in instances when employed in a quantitative sense, the word "imposed" customarily denotes the tax *before* carry-back. Thus Section 710 of the Code, the section of law (entitled "Imposition of Tax") "imposing" the Chapter 2E excess-profits tax provided that "There shall be levied, collected, and paid * * * a tax * * *." The tax which was actually levied, collected, and paid ("imposed") in this case is the tax before carry-back. So, also, Section 56 of the Code requires that the "tax *imposed*" for a taxable year shall be paid before the end of the following year, or before any carry-back to such prior taxable year can possibly arise. Indeed, the Commissioner has very recently interpreted other provisions of excess-profits tax regulations which provide for an adjustment for "taxes imposed" as referring to the tax before carry-back.

The Government argues (*Olympic Radio* Brief, p. 21) that "there were not two amounts imposed" for the taxable year there involved but "only one, and that one was the amount which finally became determinable after application" of the carry-back from a later year. If the Government is correct in stating that there was only one tax "imposed," such tax, as has been shown, would be the tax before carry-back. However, candor requires it to be said that the word "imposed" when used in a quantitative sense is sufficiently flexible to mean either the tax "*initially* imposed" or "*finally* imposed." In Section 122

(d)(6) the meaning can only be the tax "initially imposed." The statute speaks of the "tax imposed * * * *accrued within* the taxable year." As noted earlier, the only tax "imposed" which "*accrued within*" the taxable year is the tax before carry-back, that is, the tax *initially* imposed. Even if "imposed" were used in a quantitative sense in Section 122 (d)(6), therefore, it would refer to the tax before carry-back.

The interpretation adopted by the Court below would virtually read the (d)(6) adjustment out of Section 122 (b)(1) for accrual basis taxpayers since it is mathematically demonstrable that under such an interpretation accrual basis taxpayers could not ordinarily obtain the benefit of the (d)(6) adjustment under Section 122 (b)(1). Such a result could hardly be justified even if apparently called for by the "plain meaning" of the statutory language. It can certainly not be justified when it is reached by *disregarding* the "plain meaning" of that language.

## ARGUMENT

### I

### TAXES PAID WITHIN A TAXABLE YEAR BY AN ACCRUAL BASIS TAXPAYER CONSTITUTE TAXES "PAID OR ACCRUED WITHIN THE TAXABLE YEAR" UNDER SECTION 122 (d) (6).

#### A. To Construe Section 122 (d)(6) Otherwise Will Virtually Read That Section Out of the Code So Far As Accrual Basis Taxpayers Are Concerned Since Excess-Profits Taxes Do Not Ordinarily Accrue in a Loss Year.

Section 122 (a) of the Code (Appendix A, p. 57) provides, insofar as here pertinent, that "net operating loss" means the excess of deductions over gross income, with the addition to such loss (under Section 122 (d)(6)) of excess-profits taxes "paid or accrued" within the taxable year. (Appendix A, p. 59). The Court below held that only a cash basis and not an accrual basis taxpayer could include in his net operating loss taxes paid within the taxable year to meet his tax liability with respect to the preceding year. This holding will largely read Section 122 (d)(6) out of the Code so far as accrual basis taxpayers are concerned and limit its benefits to cash basis taxpayers.

Federal income and excess-profits taxes arising in one year are payable in the succeeding year. (Section 56 (a) and (b) of the Code.) Hence when a loss year follows a profit year taxpayers will *pay* the excess-profits taxes for the profit year in the loss year. Under the decision below a cash basis but not an accrual basis taxpayer can add such a tax payment to his net operating loss under Section 122 (d)(6). Accrual basis taxpayers would be permitted to take deductions only for taxes *accrued* in the year of a net operating loss. But, as pointed out by the Court of Claims in *Olympic Radio and Television, Inc.* v. *United States*, No. 10 (which is in conflict with the decision below), it is "only rarely that a taxpayer would accrue a liability for an excess-profits tax in a year in which it had a net operating loss." (108 F. Supp. 109 at 110.) This is true because in the nature of things taxes based on income cannot arise in a loss year. Hence under the decision below the benefits of Section 122 (d)(6) are, in the language of the Court of Claims, "largely illusory" in the case of accrual basis taxpayers.

The example set forth in the opinion below makes the point graphically (R. 69):

> "* * * A corporation had high profit years in 1942 and 1943 and incurred a $1,000,000 excess profits tax liability in the latter year, which it paid in 1944. In 1944 it had a net operating loss of $500,000, without regard to any § 122 (d)(6) adjustment. If an *accrual* taxpayer, the corporation would not be able to add its excess profits taxes for 1943 to its net operating loss for 1944; if a *cash* taxpayer, it would; and this in turn would mean that the cash taxpayer's net operating loss 'carry-back' to 1942 and 1943 under § 122 (b)(1) would be increased by $1,000,000, whereas the accrual taxpayer's 'carry-back' would remain at $500,000."

In its Brief in this Court in *Olympic Radio, the* Government attempts to answer the argument based on the discriminatory results of the decision below in three ways. First

(*Olympic Radio* Brief, p. 18), it points out that Section 122 (d)(6) will on occasion confer partial benefits on an accrual basis taxpayer under the interpretation adopted below. For example, when taxes of an earlier year have been contested, accrual *to the extent of the amount of taxes in contest* will take place in the year the contest is settled, which may be a loss year. In effect, the Government suggests Congress intended to limit the benefits of Section 122 (d)(6) to the relatively few taxpayers who contest tax liability. But surely it was not the purpose of Congress in enacting Section 122 (d)(6) to make equality the exception and discrimination the rule.[10]

Second, the Government (*Olympic Radio* Brief, p. 19) argues that there are other instances under the Internal Revenue Code where accrual basis taxpayers will receive advantages over cash basis taxpayers. To support this position, it is stated that when the excess-profits tax took effect in 1940 a cash basis (but not an accrual basis) taxpayer was obliged to pay tax on goods sold in 1939 which were paid for in 1940. The Government neglects to add that the reverse was true when the excess-profits tax was repealed. Then an accrual basis (but not a cash basis) taxpayer was obliged to pay tax on goods sold in 1945 but not paid for until 1946. This type of difference in treatment between cash and accrual basis taxpayers equalizes itself over the long run or affects at most years of transition when a provision of law is adopted or repealed. But the discrimination here involved is of a different type. It is not confined to years of transition. It would be a continuing discrimination in *every year* throughout the life of Section 122 (d)(6).

Third, the Government (*Olympic Radio* Brief, pp. 13, 20) refers to the language of *Crooks* v. *Harrelson*, 282 U. S. 55,

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[10] The other situation where under the decision below Section 122 (d)(6) might benefit an accrual basis taxpayer (*Olympic Radio* Brief, p. 19) involves *abnormal* income and would arise even more rarely than the one discussed in the text.

60 (1930) and other cases as to the propriety of consideration of consequences in the interpretation of statutes and as to deductions being matters of legislative grace. Of course broad generalizations such as those referred to can hardly be deemed dispositive of concrete cases. The governing principle, in any event, is set forth in *United States* v. *American Trucking Associations*, 310 U. S. 534 at 543 (1940) where this Court said:

> "There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes. Often these words are sufficient in and of themselves to determine the purpose of the legislature. In such cases we have followed their plain meaning [citing, *inter alia*, *Crooks* v. *Harrelson*]. When that meaning has led to absurd or futile results, however, this Court has looked beyond the words to the purpose of the act. Frequently, however, even when the plain meaning did not produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole' this Court has followed that purpose, rather than the literal words [citing, *inter alia*, *Helvering* v. *Morgan's Inc.*, 293 U. S. 121 (1934), *infra*, p. 20, involving the net loss *deduction* predecessor of Section 122, described by the Court as a "remedial section"]."[11]

It is significant that both the Court of Claims and the Court below, although reaching different conclusions as to the meaning of Section 122 (d)(6), recognized that the construction adopted below would yield inequitable results

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[11] See, also, *Markham* v. *Cabell*, 326 U. S. 404 at 409 (1945), where with respect to a "remedy" under another statute which "would be quite illusory and ineffective" if the statutory language "were read literally" this Court said: "The process of interpretation also misses its high function if a strict reading of a law results in the emasculation or deletion of a provision which a less literal reading would preserve." And in *Farmers Reservoir & Irrigation Co.* v. *McComb*, 337 U. S. 755 at 764 (1949), this Court stated it had "consistently refused to pervert the process of interpretation by mechanically applying definitions in unintended contexts."

by discriminating against accrual basis taxpayers. Indeed, the Court below stated, "we would not be candid if we failed to recognize the force of what the taxpayer argues here." (R. 69.) However, the Court felt precluded from recognizing these equities by what it deemed the "plain mandate of the statute." (R. 69.) As just indicated, even the "plain meaning" of language would not require that unreasonable or futile results be reached in interpreting a statute. In any event, as shown in the next point of this Brief, the provisions of the Code in which the Court below found its mandate—Sections 43 and 48 (c)—are not applicable to Section 122 (d)(6).

**B. The Established Rule Is That the Term "Paid or Accrued" May Have Different Meanings in the Code and That, Where Appropriate to Carry Out the Statutory Purpose, the Ordinary Meaning of Either Paid or Accrued Will Be Applied Rather Than the Definition in Section 48 (c).**

Section 48 (c) of the Code provides that "When used in this chapter" (Chapter 1 entitled "Income Tax") "the terms * * * 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part." (Appendix A, p. 56.) Section 43 provides that "The deductions * * * provided for in this chapter shall be taken for the taxable year in which 'paid or accrued' * * * dependent upon the method of accounting upon the basis of which the net income is computed. * * *." (Appendix A, p. 55.) Section 41 is of similar purport. (Appendix A, p. 55.) The Court below held these sections to be a "plain mandate" which controlled Section 122 (d)(6) so that it was precluded from considering the statutory purposes (R. 67) and effects (R. 69) in interpreting that section. The Court therefore ruled that the taxpayer, being on the accrual basis, could not take account under Section 122 (d)(6) of excess-profits taxes *paid* within the taxable year.

In cases governed by Sections 48 (c) and 43 an accrual basis taxpayer may only take into account items accrued

within the taxable year. Thus, an accrual basis taxpayer may only take a deduction *under Section 23 (c)* for taxes accrued with the taxable year.[12] But taxpayer contends that Sections 48 (c) and 43 are not applicable to this case.

It is the established rule that the term "paid or accrued" may have different meanings in the Internal Revenue Code, and that, where appropriate to carry out the statutory purpose, the ordinary meaning of *either* "paid or accrued" will be applied rather than the statutory definition in Section 48 (c). *Commissioner* v. *Clarion Oil*, 148 F. (2d) 671 (App. D. C. 1945),[13] *cert. den.*, 325 U. S. 881 (1945); *Aramo-Stiftung* v. *Commissioner*, 172 F. (2d) 896 (C.C.A. 2d, 1949); *Birmingham* v. *Loetscher Co.*, 188 F. (2d) 78 (C.C.A. 8th, 1951); *Wm. J. Lemp Brewing Co.*, 18 T. C. 586, 600-601, acquiesced in by the Commissioner, 1952-2 C. B. p. 2; *Harry M. Stevens, Inc.* v. *Johnson*, 115 F. Supp. 310 (S.D. N.Y. 1953), on appeal to the Court of Appeals for the Second Circuit.

The Government having acquiesced in the *Clarion Oil* line of cases, the term "paid or accrued" by hypothesis has more than one meaning in the Internal Revenue Code. In a case involving the application of the statutory predecessor of Section 48 (the definition section here involved) to the statutory predecessor of Section 122 (the net operating loss deduction provision), this Court rejected the Government's argument that the phrase "taxable year" (now defined in Section 48 (*a*)) must be given the same meaning throughout the loss carry-forward section (now in Section 122). (*Helvering* v. *Morgan's Inc.*, 293 U. S. 121 (1934), involving Sections 200 (a) and 206 (b) of the Revenue Act of 1926, c. 27, 44 Stat. 9.) The Court, speaking through Mr. Justice Stone, stated (at p. 128):

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[12] The Government's argument on pages 11-16 of its Brief in *Olympic Radio* is primarily addressed to this point, which taxpayer has always conceded.

[13] "It is enough if the tax for that income was *either* 'paid or accrued' in the taxable year." (Italics supplied.) 148 F. (2d) at 676. See, also, 148 F. (2d) at 675.

> "The same meaning need not always be attributed to a phrase which, by hypothesis, has more than one meaning for purposes of statutory construction."

The Court, therefore, adopted the construction of "taxable year" which would in its judgment best fulfill the statutory purposes. Under the authority of that case, the meaning to be accorded "paid or accrued" in Section 122 is that appropriate to carry out the Congressional purpose. As already shown, effectuation of that purpose requires that accrual basis taxpapers be accorded the same right to an effective deduction for excess-profits taxes as Congress admittedly accorded to cash basis taxpayers.

While accepting the *Clarion Oil* rule that the term "paid or accrued" might have a different meaning in the Code than that set forth in Section 48 (c), the Court below held that line of cases, which arose under Chapter 2 of the Code,[14] not applicable under Chapter 1 of the Code, stating that (R. 68):

> "* * * Chapter 2 contains no provisions comparable to § 48 (c) and § 43 of Chapter 1 defining the phrase 'paid or accrued.'"

In this the Court below was plainly in error, the Court having overlooked Section 507 (a) of the Code (Appendix A, p. 61) which states that

> "The terms used in this subchapter [subchapter A of Chapter 2, the statute involved in *Clarion Oil*] shall have the same meaning as when used in Chapter 1."

Not being under this misapprehension, the Court of Claims in the *Olympic Radio* case (No. 10) stated it would apply to Section 122 (d)(6) the rule of *Clarion Oil* that Section 48 (c) "should not be applied in all circumstances and re-

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[14] The Court below did not refer to *Stevens, Inc.* v. *Johnson*, 115 F. Supp. 310 (S.D. N.Y. 1953), *supra*, which arose under Chapter 1 (Section 102) of the Code.

gardless of consequences." (108 F. Supp. at 111.) In ascertaining the Congressional purpose in enacting Section 122 (d)(6), the Court of Claims appropriately took into account the discrimination against accrual basis taxpayers which would result from applying Section 48 (c) just as the Court in *Clarion Oil* (148 F. (2d) at 676), in holding Section 48 (c) inapplicable reasoned that Congress did not intend to discriminate between cash and accrual basis taxpayers.

Once the basic rule of *Clarion Oil* that the Section 48 (c) definition does not necessarily govern throughout the Code is accepted, the pertinent inquiry is into the purposes of Section 122 and the consequences of the application of Section 48 (c) to such section. (Points IA and C of this Brief.) This would be so even if the basis on which the Court in *Clarion Oil* determined not to aply Section 48 (c) was inapplicable here. But much of the reasoning of the Court in *Clarion Oil* is in fact apposite in the case of Section 122, the distinction drawn by the Court below between the two situations being untenable.

The Court below attempted to distinguish *Clarion Oil* on the ground that "the meaning of 'paid or accrued' in § 122 (d)(6) is directly involved in the computation of *net income*, for § 23 (s) allows as a deduction in 'computing net income' under § 23 'the net operating loss deduction computed under Section 122.'" (R. 68.) The Court thought this to be significant because of the first sentence of the following excerpt from the opinion in *Clarion Oil* (148 F. (2d) at 675):

> "* * * But, obviously, this definition [§ 48 (c)] was intended to apply to the method of computing *net income*, and has no reference or relevancy to the subject matter of what, for the purposes of the newly added provision in relation to personal holding companies, is taxable as *undistributed* income. In other words, having determined 'net income' in accordance with the accounting methods of the taxpayer, there is no need to consider whether an ordinary income tax was 'paid'

> or whether it was 'accrued', since in either event it was a deductible item and no longer represented *accumulations* of income * * *."

The distinction drawn by the Court below has at best only a verbal plausibility. It ignores or misapprehends both the fundamental rationale and the technical basis of the decision in *Clarion Oil* as well as the distinction between the net operating loss and the net operating loss *deduction*.

In the situation presented in the *Clarion Oil* case, the adjustment for income and excess-profits taxes "paid or accrued during the taxable year" (Section 505 (a)(1);[15] Appendix A, p. 61) was made, along with other adjustments, after the net income of *that taxable year* was determined to measure the income which a personal holding company would be required to distribute to avoid incurring the personal holding company tax. The Court ruled that Section 48 (c) was intended only to apply in computing taxable net income and would have no relevancy to the computation of income available for distribution to stockholders, or, in other words, that Section 48 (c) was inapposite where the statute sought to adjust taxable net income to produce an adjusted net income figure for special purposes. The Court further stated, as noted earlier, that Congress did not intend for the "taxpayer on an accrual basis * * * [to] be in a better position than the taxpayer on a cash basis" (148 F. (2d) at 676), a result that would have been produced by application of Section 48 (c) to the adjustment for taxes there involved. The technical ground on which the decision rested was that the language of Section 48 (c) applied only to the computa-

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[15] Actually, the applicable provisions in the *Clarion Oil* case were Sections 356 (a) (1) and 357 of the Revenue Act of 1936, as added by the Revenue Act of 1937, c. 815, 50 Stat. 813, § 1. The comparable Code sections cited are identical in all material respects. The Code sections are cited throughout this Brief in the interests of clarity since they were cited by the Court below and since the other cases in the *Clarion* line arose under the Code sections.

tion of *net income* and not to adjustments made after net income is computed.

Although Section 122 deals with a quite different problem from that dealt with in the personal holding company provisions, the two provisions are designed, through similarly worded tax adjustment clauses, to adjust net taxable income or loss so as to produce the income or loss figure required to carry out the particular purposes of each provision. In each case, application of Section 48 (c) would prevent carrying out the purpose the tax adjustment was intended to serve in such case. Thus, the (d)(6) adjustment, which is made after the "net loss" (the negative equivalent of net income) of a taxable year is obtained, was added by the 1942 Revenue Act (Appendix A, pp. 64-65) to a list of adjustments in Section 122 (d) designed to convert tax "net loss" into "net operating" or "economic" loss.[16] Section 48 (c) (which is directed toward the determination of taxable net income or "net loss") would appear to be equally inapposite to an adjustment intended to produce "economic loss," as it is to an adjustment intended to produce income available for stockholders, particularly when, in each case, application of that section would result in discrimination between cash and accrual basis taxpayers. And the same technical basis is present in each case for holding Section 48 (c) inapplicable since the (d)(6) adjustment for "taxes" paid or accrued within the taxable year is made after "net loss" (excess of deductions over gross income) for *such taxable year* is determined. Thus Section 48 (c) applies to the computation of "net loss" but not to the Section 122 (d)(6) adjustment made after "net loss" is determined to produce "net operating loss", just as in the personal holding company cases

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[16] The term "economic loss" is quoted from H. Rep. 855, 76th Congress, 1st Sess., p. 17, 1939—2 C. B. p. 517, the committee report dealing with Section 122 as originally enacted in the Revenue Act of 1939.

Section 48 (c) applies to the computation of net income but not to the computation of undistributed income.

As previously noted, the distinction drawn by the Court below does not take into account the rationale of *Clarion Oil*. Nor can such distinction be sustained on the technical ground suggested by the Court below (R. 68; see p. 22, *supra*) that the Section 122 (d)(6) adjustment is "directly involved" in the computation of net income. Of course, the (d)(6) adjustment enters into the computation of the net operating loss for a taxable year, which, after further adjustments and amalgamation with carry-overs and carry-backs of other years, ultimately produces the net operating loss *deduction*, which deduction enters into the computation of the net income of a *different* year. But the definitions in Sections 48 (c) and 43 even where applicable determine only whether a deduction was paid or accrued in the year in which it is sought to take the deduction. Neither Section 43 nor 48 (c) can possibly apply, therefore, to the net operating loss *deduction* itself. The amount of the net operating loss *deduction* is computed by a specified formula with reference to the "net operating losses" of *other years* and the right to such deduction is not, of course, dependent upon whether such deduction was "paid or accrued" in the year the deduction is taken. Only in computing such *"net operating losses"* [17] of other years is there a question of whether excess-profits taxes were "paid or accrued." And in such other years, as pointed out in the preceding paragraph, the situation is comparable to the *Clarion Oil* line of cases, since the adjustment for taxes "paid or accrued within the taxable year" is made after the "net loss" for

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[17] In *Reo Motors, Inc.* v. *Commissioner*, 338 U. S. 442 at 450 (1950), this Court disposed of arguments made with respect to other questions arising under Section 122 by stating such arguments "ignore the trichotomy plainly established with respect to § 122", the reference being to the *net operating loss*, the net operating loss carry-over and carry-back, and the net operating loss *deduction*.

such taxable year is determined and hence is not governed by Section 48 (c).[18]

The untenability of this distinction of the *Clarion Oil* case drawn by the Court below is also illustrated by the foreign personal holding company provisions of Supplement P of *Chapter 1* of the Code (Section 331, *et seq.*). These closely parallel the personal holding company provisions of Chapter 2 (Section 500, *et seq.*), there being identical adjustments to net income in each case for specified taxes paid or accrued during the taxable year. (Sections 336 and 505; Appendix A, pp. 60 and 61.) However, instead of a penalty tax being levied upon the undistributed Supplement P net income of the foreign personal holding company (as it is (Section 500) in the case of "undistributed subchapter A net income" of domestic personal holding companies), an allocable portion of "undistributed Supplement P net income" is included as a constructive dividend in the *gross income for the same taxable year* of the stockholders of foreign personal holding companies under Section 337. Section 337 was described in the pertinent Congressional committee report [19] as a provision "which treats the income of the foreign corporate entity as the income of the shareholders * * * and requires them to report as their income the undistributed net income of such foreign personal holding companies."

The undistributed Supplement P net income is thus much more "directly involved" in the *computation of net income* than is the net operating loss. The former becomes part of the shareholders' income for the *same taxable year* in which

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[18] The suggestion of the Court below (R. 68) that Sections 43 and 48 (c) govern the computation of the net operating loss *itself* stems from the Court's misconception (p. 21, *supra*) that the *Clarion Oil* decision was reached because such sections were not contained in Chapter 2.

[19] H. Rep. No. 1546, 75th Cong., 1st Sess., p. 14, 1939 C. B. (Part 2), p. 713.

the taxes were "paid or accrued." The latter merely affects the net income of a *different taxable year*. It would hardly be suggested that the *Clarion Oil* decision does not apply to foreign personal holding companies since the foreign personal holding company provisions are modeled on the personal holding company provisions.[20] But since the necessary result of accepting the distinction of *Clarion Oil* drawn by the Court below would be that the *Clarion Oil* decision would not apply to foreign personal holding companies, such distinction is evidently an untenable one.

Although the Government attempts, in its Brief in *Olympic Radio* (pp. 16-17), to distinguish, upon the basis just discussed, the *Clarion Oil* case (in which it has acquiesced), the main thrust of its argument cannot be squared with that decision. Thus, the Government cites (Brief, p. 14) cases like *United States* v. *Anderson*, 269 U. S. 422 (1926), which the Court in *Clarion Oil* held to be "inapposite" because they deal with the deduction under Section 23 (c) of taxes for purposes of "net income." (148 F. (2d) p. 675, footnote 14.) So, also, the Government (Brief, pp. 5, 15) deems it significant that the taxpayer does not suggest a recomputation of the tax for the whole of its operations on a cash basis. But, in the *Clarion Oil* case, the Court did not in any way suggest that the taxpayer there involved recompute all its operations on an accrual basis because it was allowed an adjustment under Section 505 (a) for taxes accrued.[21] Again, the Government (Brief, p. 15,

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[20] Indeed, the committee report on the bill which enacted the foreign personal holding company provisions into law deals with Section 336 (a) (1) (relating to taxes paid or accrued during the taxable year) by referring to the explanation in the committee report of the comparable section of the personal holding company provisions (which were revised in the same bill). H. Rep. No. 1546, 75th Cong., 1st Sess., p. 18, 1939 C. B. (Part 2), p. 717.

[21] *Reo Motors* v. *Commissioner*, 338 U. S. 442 (1950) (cited at *Olympic Radio* Brief, p. 14) merely holds that the "net operating loss" under Section 122 (a) must be computed under the law for the taxable year in which incurred, not under the law for the year

footnote 6) is concerned because taxpayer does not suggest that terms such as "net income" and "taxable year" [22] should be interpreted differently in Section 122 from the way they are understood throughout Chapter 1. But the Court in *Clarion Oil* also did not deem it necessary to its decision to suggest that such terms (which also appear in the personal holding company provisions) should be interpreted differently under such provisions than under Chapter 1.

The prior discussion has shown that the term "paid or accrued" may have different meanings in different sections of the Internal Revenue Code and that the term should be construed in Section 122 (d)(6) so as to carry out the purpose of that section. In the preceding point (IA) of this Brief, the futile role which Section 122 (d)(6) would play in the case of accrual basis taxpayers if Section 48 (c) is

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of the net operating loss deduction. Further, the quoted language applies only to "gross income" and "deductions allowed by this chapter", that is to the computation of "net loss"; it does not refer in any way to *adjustments to* "net loss."

[22] The term "taxable year" has in fact been given different meanings in different contexts by this Court in a case involving the predecessor of Section 122. *Helvering v. Morgan's Inc.*, 293 U. S. 121 (1934), discussed at pp. 20-21, *supra*.

The Government (*Olympic Radio* Brief, p. 15, footnote 7) states that the House committee which recommended the enactment of Section 122 *assumed* that the definitions contained in Section 48 would be applicable to Section 122. To support this, the Government quotes a sentence from the report of that committee (H. Rep. 855, 76th Cong., 1st Sess., p. 17 (1939—2 C. B. p. 517)) stating that "*For the purpose of ascertaining the first, second, or third preceding taxable year*, a fractional part of a year which is a taxable year under Section 48 (a), is a *preceding* taxable year." (Italics supplied.) Far from *assuming* that the definitions in Section 48 would be applicable to Section 122, the House committee apparently recognized that under *Helvering* v. *Morgan's Inc.*, *supra*, this would not necessarily be so except as to situations in which it made its intent clear. Indeed, the committee's careful limitation of the purposes to which the Section 48 (*a*) definition applies under Section 122 indicates that even that subsection does not necessarily apply for all purposes of Section 122.

held applicable has been demonstrated. The succeeding point (IC) will examine the legislative history to show that Congress made a conscious effort to avoid this very futility.

### C. The Legislative History Demonstrates That Congress Intended in Section 122 (d)(6) to Provide Real and Not Illusory Relief.

The legislative background of Section 122 (d)(6) evidences a clear Congressional purpose to afford real and not illusory relief to taxpayers under Section 122 (d)(6). Section 122 (d)(6) was enacted as Section 105 (e)(3)(C) of the Revenue Act of 1942. (Appendix A, p. 65.) Section 105 of the 1942 Act, subsections (a) through (d), changed the base for the corporate income tax by eliminating the *deduction* for excess-profits taxes (theretofore provided in Section 23(c)(2) of the Code; Appendix A, p. 63) and by substituting a *credit* (in section 26 (e) of the Code; Appendix A, p. 55) against net income equal to the amount of income subject to excess-profits taxes ("adjusted excess-profits net income").[23] Unlike a deduction, a credit is not automatically

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[23] The change was described in the pertinent committee report (H. Rep. No. 2333, 77th Cong., 2nd Sess., p. 18, 1942—2 C. B. p. 388) as follows:

> "1. Change in the Base for Corporate Tax
>
> "Under the present law, the excess-profits tax is computed before the normal tax and surtax, being allowed as a deduction in determining the bases to which those taxes apply. Thus, the portion of the adjusted excess-profits net income not taken by the excess-profits tax is subjected to the normal tax and surtax.
>
> "The bill changes this method of determining the tax base by dividing the net income into two portions, one of which is subject to excess-profits tax alone, and the other of which is subject only to normal tax and surtax. Instead of deducting the excess-profits tax itself in determining the normal and surtax bases, the bill deducts, through the form of a credit against net income, the adjusted excess-profits net income, the base upon which the excess-profits tax is computed."

taken into account in computing net income, which is defined (Section 21 (a) of the Code; Appendix A, p. 53) to mean gross income, less *deductions*, but is allowed only to the extent provided in specific sections of the Code (Section 26; Appendix A, p. 55). "Technical amendments" were therefore necessary (Section 105 (e) of the 1942 Act;[24] Appendix A, p. 64), where it was desired to extend the benefits of the Section 26 (e) credit, or benefits in lieu thereof, to sections of the Code in which the terms "net income" or "deductions" were used. Thus, subsection (e)(2) of Section 105 of the 1942 Act (Appendix A, p. 64) amended the definition of "section 102 net income", which was defined to mean "net income" with specified adjustments, so as to allow such credit.

In the immediately succeeding subsection, subsection (e)(3) (Appendix A, p. 64),[25] the draftsmen dealt with the

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[24] This section is entitled "Technical Amendments Made Necessary by Change in Base for Corporate Tax."

[25] The portion of the pertinent committee report (S. Rep. No. 1631, 77th Cong., 2nd Sess., p. 67, 1942—2 C. B. p. 556) dealing with subsections (e) (2) and (e) (3) reads as follows:

> "This section makes other technical amendments required as a result of the change in the base of the corporation tax. *In the case of corporations subject to tax under section 102 of the Code, the credit provided in section 26 (e) is also allowed by an amendment to section 102 (d) (1).* Section 122 of the Code, relating to computation of the net operating loss deduction allowed by section 23 (s) of the Code, is amended so as to allow the excess-profits tax paid or accrued within taxable years (subject to certain rules) as a deduction in computing net operating loss for, and net operating loss carry-over and carry-back from, such taxable years." (Italics supplied.)

The House Report is substantially the same and is set forth in the Government's Brief in *Olympic Radio*, p. 31, footnote 19. However, the italicized sentence quoted above (which appears in both the Senate and House report) is not set forth in the Government's Brief.

definition of "net operating loss" in Section 122 of the Code. This had been defined (in parallel fashion to "section 102 net income") as the excess of *deductions* over gross income with specified adjustments. The draftsmen did not make the Section 26 (e) credit applicable to the computation of "net operating loss" as they had in the preceding subsection made it applicable to the computation of "section 102 net income." The reason is evident. Such credit would have been useless in computing a net operating loss since there would be no income subject to excess-profits tax in a loss year.

The Section 26 (e) credit being inapposite in the case of the net operating loss, the Congress could have determined that no amendment to Section 122 was required or advisable. It did not do so. Instead, subsection (e)(3) of Section 105 of the 1942 Act added the Section 122 (d)(6) adjustment for taxes "paid or accrued within the taxable year" to the Code. The conclusion is inescapable that this adjustment was intended to provide a real benefit to taxpayers in a loss year and not an illusory one. Hence, it could only have been designed to permit taxpayers to take into account taxes of other years. Otherwise, it would have been as futile as the Section 26 (e) credit since no taxes can arise in a loss year.

There is another clear indication of the Congressional intent to permit taxpayers to take into account taxes of other years. The language of Section 122 (d)(6) was taken virtually verbatim from Section 23 (e)(2) of the Code (as in effect prior to its repeal by the 1942 Act). That section (Appendix A, p. 63) permitted a deduction for excess-profits taxes "paid or accrued within the taxable year" subject to four specified rules. Three of such rules were incorporated in Section 122 (d)(6) but a fourth (Rule A) was omitted. That rule provided:

> "The deduction shall be limited to the tax imposed for the taxable year, but any portion of such tax paid after the taxable year shall be considered as having been paid within the taxable year."

Had this rule been retained in Section 122 (d)(6), that section would have been futile since there can be no tax imposed for a loss year. Its omission also indicates a conscious attempt to provide meaningful and not theoretical relief in Section 122 (d)(6).

The Government's analysis of the legislative history (*Olympic Radio* Brief, pp. 22-34) is manifestly unsound, it being directed toward proof of the proposition that Congress did not intend to permit a corporation to take "a novel and far-reaching deduction" for taxes "*both* paid and accrued." (*Olympic Radio* Brief, p. 33.) The contention here and in *Olympic Radio* is that a taxpayer under Section 122 (d)(6) may make an adjustment for taxes *either* paid or accrued. Indeed, the Government does not consider at all subsection (e)(2) of Section 105 of the 1942 Act (which furnishes the key to the Congressional purpose) and attempts to explain the omission from Section 122 (d)(6) of Rule A of Section 23 (c)(2) as an effort by Congress to benefit cash but not accrual basis taxpayers. (*Olympic Radio* Brief, p. 26.) The Government gives no reason why the Congress should have taken such pains to benefit only the comparatively few cash basis corporate taxpayers. And it is hardly credible that, in enacting a "technical amendment" designed "to make it all come out straight",[26]

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[26] The quoted words are those of John O'Brien, Office of Legislative Counsel, House of Representatives, who explained to the Senate Finance Committee the changes from existing law made by the House in the 1942 revenue bill (Sen. Finance Comm. Hearings on H. R. 7378, 77th Cong., 2nd Sess., p. 34 at 41). The full context of the quoted language follows:

> "Now, the rest of the amendments in this section are purely technical amendments relating to getting rid of the deduction for excess-profits tax which is in the present law, and various other amendments particularly in connection with the net operating loss, in order to make them come out right. You see, when you change the basis of corporate tax it involves any number of miscellaneous amendments throughout in order to make it all come out straight."

Congress intended *sub silentio* to reverse the policy of according the same treatment to cash and accrual basis taxpayers [27] announced in the preceding year by the Congressional committees when they enacted the predecessor provision of Section 122 (d)(6).[28]

More fundamentally, the Government's analysis of the legislative history (*Olympic Radio* Brief, p. 26 *et seq.*) proceeds in substance on the premise that the Congress made a mistake in policy in enacting Section 122 (d)(6). Thus the Government argues that the "allowance of the tax itself as a deduction" grants a "double benefit", which Congress could not have intended. (*Olympic Radio* Brief, p. 27.) But if it be assumed, *arguendo*, that such is the effect of the allowance of the tax as a deduction,[29] the effect would be identical in the case of cash basis taxpayers. Yet cash basis taxpayers are admittedly entitled to deductions under Section 122 (d)(6).[30] In contrast to the doctrinaire exception

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[27] "A desire for equality among taxpayers is to be attributed to Congress rather than the reverse." *Colgate-Palmolive-Peet Co.* v. *United States*, 320 U. S. 422, 425 (1943).

[28] "It is provided that the deduction shall be allowed only in computing the income tax imposed for the taxable year for which the excess-profits tax is levied. By providing that any excess-profits tax paid after the taxable year shall be deemed to have been paid within the taxable year, *the same treatment is accorded to taxpayers on the cash basis as is accorded to taxpayers on the accrual basis.*" (Italics supplied.) H. Rep. No. 1040, 77th Cong., 1st Sess., p. 46, 1941—2 C. B. 450; S. Rep. 673 (Part 1), 77th Cong., 1st Sess., p. 37, 1941—2 C. B. 495-496.

[29] The suggestion that a "double benefit" is involved merely reflects the Government's consistent refusal to accept the Congressional policy determination to allow excess-profits *taxes* incurred to be taken into account in computing economic loss.

[30] The same vice is present in the Government's contentions (1) that the purpose of the net operating loss deduction was not to accord taxpayers with loss years advantages over those with stable profits (*Olympic Radio* Brief, p. 27), (2) that Section 122 (d) (6) was enacted as part of a war revenue measure (*Olympic Radio* Brief, p. 27), and (3) that Sections 711 (a) (1) (J) and

taken by the Government to the Congressional policy of permitting a deduction for excess-profits taxes under Section 122 (d)(6), the taxpayer, in its analysis of the legislative history, accepts Section 122 (d)(6) as an expression of the Congressional policy to permit taxpayers to take into account excess-profits taxes in determining their "net operating" or economic loss.[31]

## II

## THE EXPLICIT MANDATE OF SECTION 122 (b)(1) REQUIRES COMPUTATION OF THE CARRY-BACK TO 1945 IN THE MANNER CONTENDED FOR BY TAXPAYER

### A. The Principle of "Matching" Which the Court Below Read Into Section 122(b)(1) Is Specifically Negatived by that Section.

The Court below felt compelled by the "plain mandate" of the statute (R. 69) to hold under Question 1 that an accrual basis taxpayer could take into account under Sec-

711 (a)" (2) (L) support its position. (*Olympic Radio* Brief, p. 32, footnote 20, and p. 34, footnote 21.) These arguments would apply equally to cash basis taxpayers who admittedly are entitled to the benefits of Section 122 (d) (6).

And, in any event, these contentions are intrinsically unsound. Argument (1) ignores the fact that all other adjustments under Section 122 (d), such as inclusion of tax-exempt interest in gross income ((d) (2)) and reduction of the deduction for percentage depletion ((d) (1)), operate to *decrease* net operating loss. Argument (2) ignores the fact that in the same war revenue measure Congress introduced the net operating loss carry-*back* provisions (along with many other substantive amendments), the adverse effect of which on the revenues was much greater than that of Section 122 (d) (6). Argument (3) has been fully considered and rejected both by the Court of Claims (*Olympic Radio* on rehearing, 110 F. Supp. 600) and by the Tax Court (*Robert Reis & Co.*, 20 T. C. 294 at 298 (1953)).

[31] The Government contended below and contends in *Olympic Radio* (Brief, p. 21), in the alternative, that the Section 122 (d) (6) adjustment is limited to the tax "imposed." This contention is discussed in detail in Points II C and D of this Brief.

tion 122 (d)(6) only excess-profits taxes "accrued" within the taxable year. In order to compute the amount of the (d)(6) adjustment for purposes of Section 122 (b)(1)(A), the Court below was thereupon required to determine the excess-profits taxes "accrued" in 1944.

The taxpayer contended below that under well-established principles (see Point II B, *infra*) the excess-profits tax "accrued" for 1944 was the tax computed on the basis of the facts existing at the end of such year and shown on the taxpayer's return for such year, and not the tax ultimately found due after application of a carry-back and other circumstances arising in a later year. The Commissioner did not dispute this principle (which he has repeatedly recognized in his rulings) and based his argument below on the use of the word "imposed" in Section 122 (d)(6) (see Point II C, *infra*). The Court below nevertheless held the excess-profits tax "accrued" for 1944 to be the tax after carry-back. (R. 72.) It made no attempt, however, to discuss the meaning of the word "accrued" or the pertinent authorities. (R. 71.) Instead it indicated that it could not follow the accepting meaning of the word "accrued" because to do so would not comport with the purpose of Section 122 (b)(1) as the Court below conceived it. (R. 71.)

This reasoning could not be reconciled with the literal approach adopted by the Court below under Question 1 even if the statutory purpose assumed by the Court were a supportable one. But, inconsistency apart, the Court's reasoning is untenable because the purpose of Section 122 (b)(1) as conceived by it is one specifically negatived by the conceded meaning of that section.

As earlier noted, Section 122 (b)(1) (Appendix A, p. 57), as applied to this case, permits the 1946 net operating loss to be carried back to 1945 to the extent such net operating loss exceeds the 1944 net income computed (Clause (B)) by determining the net operating loss deduction for 1944 without regard to the 1946 net operating loss

and (Clause (A)) by reducing such net income by the (d)(6) adjustment for taxes "paid or accrued" within the taxable year. Concededly, the starting point, the 1944 net income, is the finally determined net income for such year—$420,540.43 (R. 4; p. 5, *supra*, footnote 4)—"net income" being, of course, under Section 21 (a) the net income computed as required by the provisions of the Code. The amount of the 1946 net operating loss deduction allowed in computing such net income figure was $164,326.38. (R. 24, 38.) Thus the net income before such deduction (Clause (B)) was $584,866.81. (R. 4; p. 5, *supra*, footnote 4.)

Section 122 (b)(1)(A) requires that this amount be reduced by the (d)(6) adjustment for taxes "paid or accrued" within the taxable year. Under the decision below on Question 1, the (d)(6) adjustment was for the tax accrued. The Court below stated as its view that the tax accrued figure must "match" (that is, must be the tax computed upon the basis of) the adjusted "income" figure for that year ($584,866.81) from which it was to be subtracted under subsection (b)(1). (R. 71-72.) The Court held the tax figure which matched the adjusted "income" figure—$584,866.81—was $280,540.33, and that such figure was therefore the tax "accrued." (R. 71-72.) Paradoxically, even if the theory of "matching" be accepted, the figures adopted by the Court did not "match." The amount of $280,540.33 was the tax computed on the net income *after* carry-back—$420,540.43. (R. 4, 9; p. 5, *supra*, footnote 4, p. 6, *supra*). It was not the tax computed on the income *before* carry-back—$584,866.81—from which it was subtracted by the Court. Indeed, the excess-profits tax usually cannot "match" net income, since it is not computed on the basis of "net income" but either on the basis of "adjusted excess-profits net income" or on the basis of (with specified adjustments) "corporation surtax net income." (Section 710 (a)(1) of the Code; Appendix A, p. 61.) The former will invariably, and the latter may occasionally, differ from "net income."

More fundamentally, the admitted application of Section 122 (b)(1) to other situations plainly shows that the statute does not contemplate "matching." Concededly, the (d)(6) adjustment for a cash basis taxpayer in the year 1944 would be the excess-profits tax paid in that year on *1943 income*. Under Section 122(b)(1) this figure would be applied to reduce the *1944 income*, which it cannot conceivably "match." So also, the Court below and the Government agree that an accrual basis taxpayer who settled contested tax liabilities of earlier years within the taxable year may accrue such liabilities in the year of settlement. (R. 69; *Olympic Radio* Brief, p. 18.) Thus, if a taxpayer settled a contested *1942* excess-profits liability in 1944, he would accrue the amount of the contested liability in 1944. Under Section 122 (b)(1) the amount of such accrued tax would be applied to reduce the *1944 income*, a figure which it cannot conceivably "match." And, inherently, a tax "accrued" for a particular year—the amount of which is based on the income computed upon the basis of the facts existing at the end of such year (see Point II B of this Brief, *infra*)—can*not* be expected to "match" the finally determined income for that year. The very use of the term "accrued" tax is inconsistent with the idea of matching of tax against finally determined income.

It is evident, therefore, that, even if the Court below would have been justified in disregarding the "plain mandate" of Section 122 (b)(1) to carry out an overriding Congressional purpose, no such purpose exists here. The purpose relied on by the Court below was based solely on the Court's *a priori* notions. It is nowhere expressed by the Congress and is specifically negatived by the conceded meaning of Section 122 (b)(1) in other situations and by the use of the word "accrued."

**B. The Excess-Profits Tax "Accrued" Within the Taxable Year (1944) is the Tax Reported on the Taxpayer's Return on the Basis of the Facts Existing at the End of Such Year. That is the Tax Computed on the Income Before the Carry-Back From 1946.**

The "matching" approach which the Court below read into Section 122 (b)(1) plainly being unsound, we turn to an examination of the language of Section 122 (d)(6). If the decision of the Court below on Question 1 be accepted, *arguendo*, Question 2 is limited to a determination of "the amount of tax imposed by Subchapter E of Chapter 2 * * * *accrued* within the taxable year."[32]

In determining accruals within a taxable year events occurring thereafter may not, of course, be taken into account. *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281 (1944) and cases there cited. Under that settled doctrine, the tax accrued within a taxable year is the tax computed on the basis of the facts existing in such year despite the occurrence of events in later years which change the amount of tax ultimately found due. *Stanard-Tilton Milling Co.*, 3 T. C. 1026 (1944), acquiesced in by the Commissioner, 1949-1 C. B. p. 3; *United States* v. *Detroit Moulding Corporation*, 56 F. Supp. 754, at 757-758 (E.D. Mich., 1944); Mim. 6444, 1949-2 C. B. p. 11.[33] The tax accrued within a taxable year is therefore the tax on income

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[32] If the taxpayer should prevail on Question 1, there is no dispute that the excess-profits tax *paid* in 1944 was $759,916.50 (R. 24, 38; p. 5, *supra*), the Government's argument in that situation being based on the word "imposed." See Point II C and footnote 37 of this Brief.

[33] To avoid undue complexity the discussion in the text is henceforth couched in terms of the carry-back adjustment but the same principles as to determination of the tax accrued govern the other adjustments to 1944 net income (R. 4) based on events occurring after the taxable year. Thus, the "tax accrued" in a taxable year is the tax on the income of that year before adjustment for renegotiation. *Taylor Instrument Companies*, 14 T. C. 388 (1950), acquiesced in by the Commissioner, 1950-2 C. B. p. 4; Mim. 6597, 1951-1 C. B. p. 20.

before carry-backs arising in later years and is *not* the tax finally determined after taking into account such carry-backs. As earlier noted, the Court below did not discuss the established meaning of the word "accrued" and the Commissioner did not attempt to argue that the tax "accrued" was the tax on income *after* carry-back. The Commissioner could hardly have taken a different position, for he has published a specific ruling (following accepted principles) that under an identically worded provision the tax "accrued during the taxable year" is the tax on income before carry-back.[34] (Rev. Rul. 6, 1953-1 C. B. p. 120.)

That ruling involved Section 102 (d)(1)(A) under which "Section 102 net income" is computed (in parallel fashion to "net operating loss") by reducing the net income by income and excess-profits taxes "paid or accrued during the taxable year." After holding that an accrual basis taxpayer could take into account under Section 102 (d)(1)(A) only taxes *accrued* within the taxable year,[35] the Commissioner went on to rule that income tax liability accrues at the end of a taxable year and that the tax "accrued" under Section 102 (d)(1)(A) is the tax computed before application of a carry-back from the following year. As stated in the ruling:

> "The Federal income tax liability for the taxable year 1950 accrued at the close of such taxable year. The taxpayer was required to compute its Federal income tax and file its return for such year without regard to any net operating loss carry-back. (See S. Rept. 1631, 77th Cong., 2d Sess., C. B. 1942-2, 504, 597.) The amount of the tax so computed constituted a deduction for taxes under section 102 (d)(1)(A) of the Code * * *.

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[34] *Aircraft Steel & Supply Co.* v. *State Commission of Revenue*, 173 Kans. 524, 249 P. (2d) 664 (1952) also specifically so holds (upon the basis of federal authorities) under a provision of the Kansas income tax act which permits a deduction for federal income taxes "accrued" within the taxable year.

[35] *Stevens, Inc.* v. *Johnson*, 115 F. Supp. 310 (S.D. N.Y. 1953), is to the contrary on this point. See p. 20, *supra*.

"In Mimeograph 6444 (C. B. 1949-2, 11) relating to the treatment for Federal income tax purposes of refunds of taxes, the deduction of which in prior years resulted in tax benefits, it is stated: 'Since the decision in *Burnet* v. *Sanford & Brooks Co.* (282 U. S. 359 * * * (1931)), emphasis has been given to the point that income taxation is on an annual basis. So long as an item of income or expense was properly accounted for in one period, no change is justified under this doctrine merely because events in a subsequent period might materially change the treatment of the original item.' * * *

"Accordingly, it is held that in determining the 'section 102 net income' of a corporation which keeps accounts and files returns on the accrual basis, an adjustment in Federal income tax liability for the taxable year 1950 resulting from a net operating loss carry-back from the taxable year 1951 should not be reflected in the tax deduction provided by section 102 (d)(1)(A) of the Internal Revenue Code."[36]

The authorities set forth make it evident that the excess-profits tax "accrued" in 1944 is the tax shown on the taxpayer's return for that year.

### C. The Use of the Word "Imposed" in Section 122 (d)(6) Does Not Affect Taxpayer's Contention as to the Computation of the Carry-Back to 1945.

#### 1. The Word "Imposed" is Used in Section 122 (d)(6), as in Many Other Places in the Code, Simply By Way of Description or Identification of the Tax for Which a Deduction is to be Allowed and is Not Intended as a Limitation of the Amount of the Deduction.

As already noted, Section 122 (d)(6) permits a deduction for "the amount of tax *imposed* by Subchapter E of Chapter 2 [Excess-Profits Tax] paid or accrued within the taxable year." The Government argued below and intends

[36] To the same effect is a very recent ruling, Rev. Rul. 55-28, Int. Rev. Bull. No. 3, Jan. 17, 1955, p. 65, discussed at pp. 47-48, *infra*.

to argue in this Court[37] (*Olympic Radio* Brief, pp. 21-22) that the amount of the (d)(6) adjustment is the tax "imposed" for the year and that the amount of tax "imposed" is the tax finally determined for the year after application of carry-backs. The Court below simply stated in its opinion, without discussion, that the "tax which was 'imposed' for 1944 was $280,540.33" (R. 71), the tax finally determined after carry-back. It is doubtful that anything turned on this statement since the Court summarized its conclusion to be that "The excess profits taxes which *accrued* for 1944 were $280,540.33." (R. 72.)

The word "imposed" is used in the Internal Revenue Code in two senses depending upon the context. In contexts such as that of Section 122 (d)(6), that is, where used in conjunction with the words "paid or accrued", it is invariably used by way of identification or description of or reference to a tax for which there is no popular name by which the tax can be suitably identified. In other contexts, the word "imposed" is sometimes used in a quantitative sense, that is to define the *amount* of a tax which is to be levied and collected. This point of the Brief (II C 1) will demonstrate that "imposed" was used in the former sense in Section 122 (d)(6). The next point (II C 2) will show that, even if the word "imposed" had been used in a quantitative sense, the tax "imposed" would be the tax before carry-back.

Deductions or adjustments for taxes provided for under the Internal Revenue Code are typically allowed for specified taxes "paid or accrued within the taxable year." Where such taxes have popular names with a fixed meaning they are usually identified by such names; where they do not have such names they are typically identified (in the same deduction or adjustment section) as the tax *imposed*

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[37] If taxpayer prevails on Question 1, the contention presumably will likewise be, as it was below, that the adjustment for taxes *paid* within the taxable year 1944 is the tax "imposed", which the Government contended below was $140,147.87, the tax ultimately determined to be due for 1943. See p. 5, *supra*.

by the particular section, title or chapter of a particular revenue act or of the Internal Revenue Code. In such situations the use of the word "imposed" is not of course intended to superimpose an additional quantitative limitation upon the test of whether the tax was "paid or accrued" within the taxable year, the function of defining the amount of tax referred to being performed by the words "paid or accrued."

That the word "imposed" is used merely by way of reference in Section 122 (d)(6) is made evident by the committee reports which described the meaning of that section. In the language of the Senate Finance Committee (S. Rep. No. 1631, 77th Cong., 2nd Sess., p. 67, 1942-2 C. B. p. 556):[38]

> "* * * Section 122 of the Code, relating to computation of the net operating loss deduction allowed by section 23 (s) of the Code, is amended so as to allow the *excess-profits tax paid or accrued within taxable years* (subject to certain rules) as a deduction in computing net operating loss for, and net operating loss carry-over and carry-back from, such taxable years." (Italics supplied.)

The committee report uses the words "excess-profits tax paid or accrued." It does not use the word "imposed." That word was unnecessary because from the context it was apparent that the Chapter 2E excess-profits tax was referred to. It is therefore clear that the word "imposed" is used in Section 122 (d)(6) only to designate the particular excess-profits tax referred to, and that the test of deductibility under that section is simply whether the tax was "paid or accrued" within the taxable year.

The usage reflected by Section 122 (d)(6) and the associated committee reports is also well illustrated in Section

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[38] The pertinent language of the House Ways and Means Committee report is similar. H. Rep. No. 2333, 77th Cong., 2nd Sess., p. 65, 1942-2 C. B. p. 423.

23 (c) of the Code from which the language of Section 122 (d)(6) was derived. That section (Appendix A, p. 59) allows a deduction in computing net income for taxes "paid or accrued within the taxable year" with specified exceptions. Some of the excepted taxes, such as Federal income taxes (Clause (A)) and estate and gift taxes (Clause (D)), have recognized popular names and the word "imposed" is not used to describe them. Other excepted taxes, such as specified excess-profits taxes, cannot be identified in this way and hence are identified by reference to the tax "imposed" by particular provisions of law, as, for example, in Clause (B), the "excess-profits taxes *imposed* by * * * Subchapter E of Chapter 2."[39]

This very usage has long been adopted in the pertinent Treasury regulations which currently (Regulations 118) provide as follows with respect to the Section 23 (c) deduction for "taxes paid or accrued within the taxable year" (26 C. F. R. § 39.23 (c)-1):

> "Subject to the exceptions stated in this section * * * taxes *imposed* by the United States, any State or Territory * * * *are deductible* from gross income *for the year in which paid or accrued* (see Section 43)." (Italics supplied)

The rule under Section 23 (c) of the Code and this regulation is that a deduction may be taken for taxes *accrued* within the taxable year even though the tax liability is ultimately reduced because of later events. (Point II B, *supra.*) Acceptance of the Government's contention in this case, therefore, would necessarily require a reversal of that settled rule since the regulations under Section 23 (c) use the word "imposed" in exactly the same sense as used in Section 122 (d)(6).

That the use of the word "imposed" to identify a tax does not add anything to the test of the phrase "taxes

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[39] Other examples of this usage are Sections 336 (a) and 505 (a) of the Code. (Appendix A, pp. 60 and 61.)

paid or accrued" is also graphically illustrated by the changes made in the form of Section 23 (c) from time to time. Upon original enactment in the Second Revenue Act of 1940 (c. 757, 54 Stat. 974, Sec. 201), the Chapter 2E excess-profits tax was not deductible under Section 23 (c) of the Code. Thus Section 23 (c)(1), as amended by the Second Revenue Act of 1940 (Appendix A, p. 62), allowed a deduction for

> "Taxes *paid or accrued* within the taxable year, *except*—
>
> "(1) Federal income, war-profits, and *excess-profits taxes* (other than the excess-profits tax imposed by section 106 of the Revenue Act of 1935 (49 Stat. 1019), or by section 602 of the Revenue Act of 1938 (52 Stat. 567), and *other than the declared value excess-profits tax imposed by section 600*)." (Italics supplied.)

The excess-profits taxes for which deductions were permitted were the so-called declared value excess-profits taxes. Specifically, it will be observed that the deduction for "taxes paid or accrued" was permitted with respect to the declared value excess-profits tax *imposed* by Section 600. In the Revenue Act of 1941 (c. 412, 55 Stat. 687, sec. 202), the Chapter 2E excess-profits tax was made deductible under Section 23 (c) of the Code. Since as a general rule excess-profits taxes would thus be deductible, the form of Section 23 (c) was revised so as to list in the exception clause only those excess-profits taxes which could *not* be deducted. Thus Section 23 (c)(1) was amended (Appendix A, p. 63) to permit a deduction for

> "Taxes *paid or accrued* within the taxable year *except*—
>
> " * * *
>
> "(B) war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery

Act, or section 702 of the Revenue Act of 1934, or by any such provisions as amended or supplemented." (Italics supplied.)

"The declared value excess-profits tax *imposed* by section 600", which was deductible under Section 23 as amended by the Second Revenue Act of 1940, became deductible under the general language "taxes paid or accrued" without any reference to the word "imposed" under Section 23 as amended by the Revenue Act of 1941. This change in form is not even mentioned in the pertinent committee reports, the discussion being confined to the change of law as to the deductibility of the Chapter 2E excess-profits tax. H. Rep. No. 1040, 77th Cong., 1st Sess., p. 46, 1941-2 C. B. p. 450; S. Rep. 673 (Part 1), 77th Cong., 1st Sess., pp. 37-38, 1941-2, C. B. pp. 495-496. The test for deductibility of declared-value excess-profits taxes was, of course, no different under the Code after the Revenue Act of 1941 than it was under the Code prior thereto.

This pattern of usage in Section 23 is especially significant since, as noted in the discussion of the legislative history of Section 122 (d)(6) under Question 1 of this Brief (p. 31, *supra*), Section 122 (d)(6) was taken virtually verbatim from Section 23 (c)(2) of the Code as amended by the Revenue Act of 1941. (Appendix A, p. 63.) And from what has been said it is evident that when Section 23 (c)(2) spoke of "the excess-profits tax imposed by Subchapter E of Chapter 2", the word "imposed" was employed simply by way of identification of the particular excess-profits tax referred to.

**2. Even if the Word "Imposed" Were Used in a Quantitative Sense in Section 122 (d)(6), the Tax "Imposed" Would be the Excess-Profits Tax Before Carry-Back.**

As earlier noted, the word "imposed" is sometimes used in a quantitative sense. This is true in Section 710 of the Internal Revenue Code (Appendix A, p. 61), the taxing section "imposing" the Chapter 2E excess-profits tax,

the tax for which a deduction is permitted under Section 122 (d)(6). The section is entitled "*Imposition* of Tax" and subsection (a) thereof is entitled "*Imposition.*" Subsection (a) reads as follows:

> "There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess-profits net income, * * * a tax equal to * * *."

In other words, the tax "imposed" is the tax levied, collected, and paid.[40] As indicated in the Statement on p. 6, *supra*, the tax before carry-back was the tax actually levied (assessed), collected and paid in this case. Hence, such amount would be the tax "imposed" if the word were construed in a quantitative sense. The fact that a refund of tax is subsequently made does not negate the fact that the amount originally due was actually *imposed*, that is assessed and paid.

There are other instances in the Code where the context also indicates that "tax imposed", even when used quantitatively, refers to the tax *before* carry-back:

1. Under Section 271(a) of the Code (Appendix A, p. 60), "deficiency" means, insofar as here pertinent, the amount by which "*the tax imposed* by this chapter" exceeds the amount shown on the taxpayer's return. Interest is payable, under Section 292 (a) (Appendix A, p. 60), upon the amount determined as a deficiency. In *Manning* v. *Seeley Tube & Box Co.*, 338 U. S. 561 (1950), this Court held a taxpayer liable to pay interest on a deficiency computed

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[40] In the Internal Revenue Code of 1954 (68A Stat. 3 at 5), a change in terminology was made in Section 1 and other taxing sections. Prior thereto, it was provided that taxes shall be "levied, collected, and paid", as in Section 710 of the 1939 Code quoted in the text. Under the 1954 Code, the taxing sections provide that taxes are "hereby imposed." The committee reports state:

> "* * * The use of the word 'imposed' rather than 'levied, collected, and paid' is only a modernization of language." H. Rep. No. 1337 (83rd Cong., 2nd Sess.), p. A-9; S. Rep. No. 1622 (83rd Cong., 2nd Sess.), p. 159.

on the basis of the tax before carry-back. Under that decision, the term "tax imposed" (which forms the basis for the computation of a deficiency), as used in Section 271 (a), is the tax *before* carry-back.

2. Section 56 of the Code (Appendix A, p. 56) provides that the "tax imposed" for a taxable year shall be paid before the end of the following year, or before any carry-back to such prior taxable year can possibly arise. The term "tax imposed", as used in Section 56, necessarily means the tax before carry-back.

3. Section 3779 (a) of the Code (Appendix A, p. 62) permits a taxpayer to obtain an extension of time "for payment of all or part of any *tax imposed*" for the taxable year immediately preceding the taxable year in which a net operating loss carry-back is *expected* to arise. At the time payment of the "tax imposed" is due, the carry-back has not yet arisen. The term "tax imposed", as used in Section 3779 (a), necessarily means the tax *before* carry-back.

Indeed, the Internal Revenue Service has very recently ruled that (in a context where the term "tax imposed" is used in a quantitative sense), the term means the tax accrued or the tax *before* carry-back. Section 40.458-4 (a)(1) of Regulations 130 (under the Excess-Profits Tax Act of 1950, c. 1199, 64 Stat. 1137), as amended by T. D. 6065, 1954-1 C. B. p. 163, provides in part as follows:

> "* * * In computing accumulated earnings and profits as of the beginning of the taxable year, a taxpayer keeping its books and making its income tax returns on the accrual basis shall, in accordance with the principles applicable in the determination of earnings and profits, subtract the Federal *income and excess-profits taxes imposed* for the preceding taxable year." (Italics supplied.)

In Rev. Rul. 55-28, Int. Rev. Bull. No. 3, Jan. 17, 1955, p. 65, the Internal Revenue Service considered, *inter alia*,

whether under such provision (and the similar language of Section 40.437-5 (c)(2) of Regulations 130, as amended by T. D. 5952, 1952-2 C. B. p. 202, and T. D. 6065, 1954-1 C. B. p. 163) requiring that accumulated earnings be reduced by the "tax imposed" for the preceding taxable year, accumulated earnings should be reduced by the tax before or after carry-back. The Service ruled that under such provision the tax to be taken into account was the tax *before* carry-back. In the language of the ruling (at p. 67)

> "* * * accumulated earnings and profits must be decreased by the amount of accrued Federal income and excess profits tax liability for the preceding taxable year, computed * * * without benefit of any net operating loss * * * carry-back."[41]

The Government argued below, and its Brief in *Olympic Radio* in this Court indicates (at p. 21) it will argue here that "there were not two amounts imposed for" 1944, but "only one, and that one was the amount which finally became determinable after application" of the 1946 carry-back. If the Government is correct in stating that there was only one tax "imposed" for 1944, such tax, as has been shown, would be the tax before carry-back.

Although adoption of the Government's premise that there can be only one tax "imposed" for a taxable year would therefore be to the taxpayer's advantage, candor requires it to be said that this conclusion is based on an unnecessarily rigid conception of the meaning of the word. As already noted, the term "imposed"—when employed in a quantitative sense at all—is typically used in the Code in the sense of the tax actually assessed and paid, that is the tax before carry-back. However, the word "imposed" is sufficiently flexible so that under appropriate

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[41] To the same effect is Rev. Rul. 6, 1953-1 C. B. p. 120, quoted at p. 39, *supra*, to indicate that the tax "accrued" for a taxable year is the tax before carry-back. That ruling involved Section 102 (d)(1)(A), Appendix A, pp. 56-57.

circumstances it might be deemed to refer to the tax ultimately determined to be due even though a larger tax had initially been imposed. Stated otherwise, there can be a tax "*initially* imposed" for a year and one "*finally* imposed" for a year. In Section 122 (d)(6) the meaning can only be the tax "*initially* imposed." The statute speaks of the "tax imposed * * * *accrued within* the taxable year." As already pointed out, the only tax "imposed" which *accrued within* the taxable year is the tax before carry-back, that is, the tax *initially* imposed. The tax *finally* imposed (the tax after carry-back) was not the tax imposed *accrued within* the taxable year. Even if it be assumed, *arguendo*, that the word "imposed" was used in a quantitative sense in Section 122 (d)(6), therefore, it would necessarily refer to the tax *before* carry-back.

**D. The Decision Below Would Virtually Read Section 122 (d)(6) Out of the Code in the Computation of Carry-Backs Under Section 122 (b)(1) Insofar as Accrual Basis Taxpayers Are Concerned.**

The result of the decision of the Court below or of any other construction which determines the Section 122 (d)(6) adjustment under Section 122 (b)(1) to be the finally determined excess-profits tax after carry-back will be to virtually read Section 122 (d)(6) out of the Code in the case of accrual basis taxpayers,[42] as shown below:

There are two possible types of cases which may arise under Clause (A) of Section 122 (b)(1). In the first, the loss carry-back (from, say, 1946) will equal or exceed the net income (before carry-back) for the second preceding year to which the loss is first carried back (1944). Under any rule which defines the (d)(6) adjustment (for 1944) to be the tax computed on income after carry-back, there will be no (d)(6) adjustment since the carry-back will wipe out all tax liability for the second preceding year (1944) to which the carry-back is first made. In concrete terms

[42] These sections might have a limited application where contested taxes are involved. See p. 17, *supra*.

of this case, if the net operating loss carry-back from 1946 were $584,866.81 (the 1944 net income before carry-back, p. 5, *supra*) or more (as it would be if taxpayer prevails under Question 1), there would be no ultimate tax liability for 1944 and therefore no (d)(6) adjustment in 1944 in computing the amount of 1946 carry-back available in 1945.

The second possible type case is one (like the instant one if the Government prevails on Question 1) where the carry-back (from 1946)—$164,326.38—is less than the income before carry-back—$584,866.81—of the second preceding taxable year (1944). In such a case, the amount of the (1946) carry-back—$164,326.38—is by definition equal to the difference between (1) the income of the second preceding year (1944) before such carry-back, and (2) the income for such year (1944) after such carry-back. In terms of the preceding sentence, the amount of the carry-back is (1) minus (2).

Under the decision below, the amount of such 1946 carry-back available in the immediately preceding year (1945) is the amount by which the 1946 carry-back ((1) minus (2)) exceeds the difference between (1) the income of the second preceding year (1944) before such carry-back and (2A) *the excess-profits tax on* the income for such year (1944) after such carry-back. But in the type of case under consideration, the amount of the carry-back ((1) minus (2)) can never equal (much less exceed) the amount of such difference ((1) minus (2A)), as would be necessary under Section 122 (b)(1) if there is to be a carry-back from 1946 to 1945. This is so because (1) in each case is identical and (2A) is the tax on (2). But the tax computed on an amount of income can never, of course, equal such income.[43] Hence, (1) minus (2) will always be less than (1) minus the tax computed on (2). Under the formula of the Court below, therefore, there will never be any "excess" to carry back to the first preceding year

[43] Under Sections 710 (a)(1)(B) and 15 (a) (Appendix A, pp. 51, 63) the excess-profits tax can never exceed 80% of net income.

(1945). Stated otherwise, the Section 122 (d)(6) tax adjustment, if computed on the income after carry-back, can never be sufficient in amount to reduce the income before carry-back for the second year (1944) below the amount of the carry-back.

This is illustrated by the instant case where the net operating loss carry-back from 1946 as determined below—$164,326.38—is by definition equal to (1) the net income before carry-back—$584,866.81—minus (2) the net income after carry-back—$420,540.43. (P. 5, *supra*, footnote 4.) The excess-profits tax on (2), namely $280,540.33, is, of course, necessarily less than (2). Hence, the net operating loss carry-back ((1) minus (2)) cannot exceed (1) minus the tax on (2) and, under the decision below, there is no carry-back available to 1945. The same result will follow if any other amount of loss carry-back (not in excess of $584,866.81) is substituted for $164,326.38. And, as earlier shown, if there had been a carry-back of $584,866.81 or more, there would have been no ultimate tax liability for 1944 and hence likewise no (d)(6) adjustment in that year under the decision of the Court below.

The result of the interpretation of the Court below, or any other interpretation under which the (d)(6) adjustment is for the finally determined tax computed on income *after* carry-back, will, therefore, be to read Section 122 (d)(6) out of the statute for all practical purposes, insofar as accrual basis taxpayers are concerned, in the computation of carry-backs under Section 122 (b)(1). It would seem that a court would hesitate to reach such a result even if apparently called for by the "plain meaning" of the statutory language. Under Question 1, the Court felt the statutory language demanded a similar result with respect to the application of Section 122 (d)(6) to Section 122 (*a*). But, as this section of the Brief shows, the Court below reached this harsh result with respect to the application of Section 122 (d)(6) to Section 122 (*b*)(*1*), in the teeth of the accepted meaning of the statutory language and by relying on an assumed Congressional purpose negatived by the very provisions of the statute.

## CONCLUSION

It has been shown that:

(Question 1.) The construction of "paid or accrued" adopted below will virtually read Section 122 (d)(6) out of the Code in the determination of "net operating loss" under Section 122 (a) so far as accrual basis taxpayers are concerned. This result was reached below although the legislative history discloses a conscious Congressional attempt to provide meaningful relief in Section 122 (d)(6) and although it is well settled that the phrase "paid or accrued" may, when appropriate to carry out the statutory purposes, be construed to mean *either* paid or accrued.

(Question 2.) The recognized meaning of the term tax "accrued" is the tax computed on income before carry-backs arising in later years. The use of the word "imposed" is simply a customary way of designating the particular tax referred to and does not alter this meaning. The concept of "matching" which induced the Court below to disregard the statutory language in interpreting Section 122 (b)(1) is one specifically negatived by other admitted applications of that section. Indeed, in the case of accrual basis taxpayers the decision below will for all practical purposes eliminate the (d)(6) adjustment from the statute in computing carry-backs under Section 122 (b)(1).

For the foregoing reasons, the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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## APPENDIX A

Internal Revenue Code of 1939 [c. 2, 53 Stat. 1; 26 U. S. C. 1940, 1946, and 1952* eds.] with Amendments Applicable to Taxable Years Here Involved:

SEC. 15. [As amended by Sec. 104 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687] SURTAX ON CORPORATIONS.

(a) [As amended by Sec. 105 (b) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Corporation Surtax Net Income.*—For the purposes of this chapter, the term "corporation surtax net income" means the net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e) and minus the credit for dividends received provided in section 26 (b) * * *.
(26 U. S. C. 1940 ed., Supp. III, Sec. 15.)

SEC. 21. NET INCOME.

(a) *Definition.*—"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

* * * * *

(26 U. S. C. 1952 ed., Sec. 21.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) [As amended by Sec. 202 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687] *Taxes Generally.*—

(1) *Allowance in General.*—Taxes paid or accrued within the taxable year, except—

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*For convenience the 1952 edition of the United States Code is cited where the provisions as set forth in the 1952 edition were applicable to the years here involved. Earlier editions are cited in connection with certain sections because the 1952 edition reflects amendments to those sections which were not applicable to the taxable years here involved.

(A) Federal income taxes;

(B) [As amended by Sec. 105 (c) (1) of the Revenue Act of 1942, c. 619, 56 Stat. 798] war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, section 702 of the Revenue Act of 1934, or Subchapter E of Chapter 2, or by any such provisions as amended or supplemented;

(C) [As amended by Sec. 158 (b) of the Revenue Act of 1942, *supra*] income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States, if the taxpayer chooses to take to any extent the benefits of section 131.

(D) [As amended by Sec. 202 (a) of the Revenue Act of 1941, *supra*, and Sec. 111 of the Revenue Act of 1943, c. 63, 58 Stat. 21] estate, inheritance, legacy, succession, and gift taxes;

(E) [As amended by Sec. 202 (a) of the Revenue Act of 1941, *supra*, and Sec. 111 of the Revenue Act of 1943, *supra*] taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges; and

(F) [As added by Sec. 111 of the Revenue Act of 1943, *supra*] Federal import duties, and Federal excise and stamp taxes (not described in subparagraph (A), (B), (D), or (E)), but this subsection shall not prevent such duties and taxes from being deducted under subsection (a).

[Sec. 23 (c) as amended by the Second Revenue Act of 1940 appears at Appendix A, p. 62. Sec. 23 (c) as amended by the Revenue Act of 1941 appears at Appendix A, p. 63.]

* * * * *

(s) [As added by Sec. 211 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss De-*

*duction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provi led in the various sections imposing tax—

(e) [As added by Sec. 105 (d) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Income Subject to Excess-Profits Tax.*—In the case of any corporation subject to the tax imposed by Subchapter E of Chapter 2, an amount equal to its adjusted excess-profits net income (as defined in section 710 (b). * * *

(26 U. S. C. 1940 ed., Supp. III, Sec. 26.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the

basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *
(26 U. S. C. 1952 ed., Sec. 43.)

SEC. 48. DEFINITIONS.

When used in this chapter—

* * * * *

(c) *"Paid or Incurred," "Paid or Accrued."*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * * *

(26 U. S. C. 1952 ed., Sec. 48.)

SEC. 56. PAYMENT OF TAX.

(a) *Time of Payment.*—The total amount of tax imposed by this chapter shall be paid on the fifteenth day of March following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the third month following the close of the fiscal year.

(b) *Installment Payments.*—[As amended by Sec. 5 (d) of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126] * * * the taxpayer may elect to pay the tax in four equal installments, in which case the first installment shall be paid on the date prescribed for the payment of the tax by the taxpayer, the second installment shall be paid on the fifteenth day of the third month, the third installment on the fifteenth day of the sixth month, and the fourth installment on the fifteenth day of the ninth month, after such date. * * *
(26 U. S. C. 1946 ed., Sec. 56.)

SEC. 102. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS.

* * * * *

(d) *Definitions.*—As used in this chapter—

(1) [As amended by Sec. 138 of the Revenue Act of 1942, *supra*] *Section 102 Net Income.*—The term

"section 102 net income" means the net income, computed without the benefit of the capital loss carry-over provided in section 117 (e) from a taxable year which begins after December 31, 1940, and computed without the net operating loss deduction provided in section 23 (s), minus the sum of—

(A) [As amended by Sec. 202 (b) of the Revenue Act of 1941, *supra*] *Taxes.*—Federal income, war-profits, and excess-profits taxes (other than the tax imposed by Subchapter E of Chapter 2 for a taxable year beginning after December 31, 1940) paid or accrued during the taxable year, to the extent not allowed as a deduction by section 23, but not including the tax imposed by this section or a corresponding section of a prior income-tax law.

* * * * *

(26 U. S. C. 1952 ed., Sec. 102.)

SEC. 122. [As added by Sec. 211 (b) of the Revenue Act of 1939, *supra*] NET OPERATING LOSS DEDUCTION.

(a) [As amended by Sec. 105 (e) (3) (A) of the Revenue Act of 1942, *supra*]. *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [As amended by Sec. 153 (a) of the Revenue Act of 1942, *supra*]. *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by deter-

mining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(2 *Net operating loss carry-over.*— If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year.)

(c) [As amended by Secs. 105 (e) (3) (B) and 153 (b) of the Revenue Act of 1942, *supra*] *Amount of Net Operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26 (e));

(d) [As amended by Sec. 105 (e) (3) (C) of the Revenue Act of 1942, *supra*] *Exceptions, Additions, and*

*Limitations.*—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114 (b) (2), (3), or (4);

(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

(3) No net operating loss deduction shall be allowed;

(4) [As amended by Sec. 150 (e) of the Revenue Act of 1942, *supra*] Gains and losses from sales or exchanges of capital assets shall be taken into account without regard to the provisions of section 117 (b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains.

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions and limitations specified in paragraphs (1) to (4) of this subsection.

(6) [As added by Sec. 105 (e) (3) (C) of the Revenue Act of 1942, *supra*] There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or

excess-profits taxes paid to any foreign country or possession of the United States;

(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * * *

(26 U. S. C. 1946 ed., Sec. 122.)

SEC. 271. DEFINITION OF DEFICIENCY.

As used in this chapter in respect of a tax imposed by this chapter "deficiency" means—

(a) The amount by which the tax imposed by this chapter exceeds the amount shown as the tax by the taxpayer upon his return * * *.

(26 U. S. C. 1940 ed., Sec. 271.)

SEC. 292. INTEREST.

Interest upon the amount determined as a deficiency shall be assessed at the same time as the deficiency * * *.

(26 U. S. C. 1940 ed., Sec. 292.)

SEC. 336. SUPPLEMENT P NET INCOME.

For the purposes of this chapter the term "Supplement P net income" means the net income with the following adjustments:

(a) *Additional Deductions.*—There shall be allowed as deductions—

(1) Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23; but not including the tax imposed by section 102, section 500, or a section of a prior income-tax law corresponding to either of such sections.

* * * * *

(26 U. S. C. 1952 ed., Sec. 336.)

SEC. 505. SUBCHAPTER A NET INCOME.

For the purposes of this subchapter the term "Subchapter A Net Income" means the net income with the following adjustments:

(a) *Additional Deductions.*—There shall be allowed as deductions.—

(1) Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23; but not including the tax imposed by section 102, section 500, or a section of a prior income-tax law corresponding to either of such sections.

* * * * *

(26 U. S. C. 1952 ed., Sec. 505.)

SEC. 507. MEANING OF TERMS USED.

(a) *General Rule.*—The terms used in this subchapter shall have the same meaning as when used in chapter 1.

* * * * *

(26 U. S. C. 1952 ed., Sec. 507.)

SEC. 710. [As added by Sec. 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974] IMPOSITION OF TAX.

(a) [As amended by Sec. 201 of the Revenue Act of 1941, *supra*] *Imposition.*—

(1) [As amended by Sec. 202 of the Revenue Act of 1942, *supra*] *General Rule.*—There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess-profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser:

(A) [As amended by Sec. 202 (a) of the Revenue Act of 1943, c. 63, 58 Stat. 21] 95 per centum of the adjusted excess profits net income, or

(B) [As amended by Sec. 202 (b) of the Revenue Act of 1943, *supra*] an amount which when added to the tax imposed for the taxable year under Chapter 1 (other than section 102) equals 80 per centum of the corporation surtax net income, computed under section 15 or Supplement G, as the case may be, but without regard to the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter), and without regard to 80 per centum of the credit provided in section 26 (h) (relating to credit for dividends paid on certain preferred stock).

* * * * *

(26 U. S. C. 1952 ed., Sec. 710.)

SEC. 3779. [As added by Sec. 4 (a) of the Tax Adjustment Act of 1945, c. 340, 59 Stat. 517] EXTENSIONS OF TIME FOR PAYMENT OF TAXES BY CORPORATIONS EXPECTING CARRY-BACKS.

(a) *In General.*—If a corporation, in any taxable year ending on or after September 30, 1945, files with the collector a statement, as provided in subsection (b), with respect to an expected net operating loss carry-back or unused excess profits credit carry-back from such taxable year, the time for payment of all or part of any tax imposed by chapter 1 or 2 for the taxable year immediately preceding such taxable year shall be extended, to the extent and subject to the conditions and limitations hereinafter provided in this section.

* * * * *

(26 U. S. C. 1946 ed., Sec. 3779.)

Sec. 23 (c) of the Internal Revenue Code of 1939 as Amended by Sec. 506 (b) of the Second Revenue Act of 1940 [c. 757, 54 Stat. 974]:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) *Taxes Generally.*—Taxes paid or accrued within the taxable year, except—

(1) Federal income, war-profits, and excess-profits taxes (other than the excess-profits tax imposed by section 106 of the Revenue Act of 1935 (49 Stat. 1019), or by section 602 of the Revenue Act of 1938 (52 Stat. 567), and other than the declared value excess-profits tax imposed by section 600);

* * * * *

(26 U. S. C. 1940 ed., Sec. 23.)

Sec. 23 (c) of the Internal Revenue Code of 1939 as Amended by Sec. 202 (a) of the Revenue Act of 1941 [c. 412, 55 Stat. 687]:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) *Taxes Generally.*—

(1) *Allowance in general.*—Taxes paid or accrued within the taxable year, except—

* * * * *

(B) war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, or section 702 of the Revenue Act of 1934, or by any such provisions as amended or supplemented;

* * * * *

(2) *Excess-profits tax under chapter 2E—special rules.*—For the purposes of this subsection, in the case of the excess-profits tax imposed by Subchapter E of Chapter 2—

(A) The deduction shall be limited to the tax imposed for the taxable year, but any portion of such tax paid after the taxable year shall be considered as having been paid within the taxable year;

(B) No reduction in such tax shall be made by reason of the credit for income, war-profits, or

excess-profits taxes paid to any foreign country or possession of the United States;

(C) Such tax shall be computed without regard to the adjustments provided in section 734; and

(D) Such tax, in the case of a consolidated return under section 730, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * * *

(26 U. S. C. 1940 ed., Supp. I, Sec. 23.)

[Sec. 23 (c) as amended by later Revenue Acts appears at Appendix A, p. 53]

Revenue Act of 1942 [c. 619, 56 Stat. 798]:

SEC. 105. TAX ON CORPORATIONS.

* * * * *

(e) *Technical Amendments Made Necessary by Change in Base for Corporate Tax.*—

* * * * *

(2) *Computation of section 102 net income.*—Section 102 (d) (1) (relating to the definition of section 102 net income) is amended by inserting at the end thereof the following new subparagraph:

"(D) *Income Subject to Excess-Profits Tax.*—The credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e)."

(3) *Computation of net operating loss deduction.*—Section 122 (relating to net operating loss) is amended as follows:

(A) Subsection (a) is amended to read as follows:

"(a) *Definition of Net Operating Loss.*—As used in this section, the term 'net operating loss' means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d)."

(B) Subsection (c) is amended by striking out the parenthesis at the end thereof and inserting in lieu thereof the following: "and without the credit provided in section 26 (e))".

(C) Subsection (d) is amended by striking out "exceptions and limitations" and inserting in lieu thereof "exceptions, additions, and limitations" and by inserting at the end thereof the following new paragraph:

"(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

"(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

"(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

"(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary."